Event Transcript

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Start of Transcript

Rick Lee: If everyone could just take their seats, those that are here. For those that are online, welcome. My name is Rick Lee, I'm Chairman of Oil Search. Thank you for joining us for today's results announcement and presentation. We have Peter Botten, Stephen Gardiner, Julian Fowles, Ian Munro and Keiran Wulff here. I know it's a busy day. I know you've all got plenty of other things to do and I think you - most of you will have seen the presentation, so we will get through the delivery as quickly as we can, so we can leave maximum time for questions. If I can hand over to Peter, thanks.

Peter Botten: Thanks everybody and thanks very much for attending either in person or virtually through the web. I know too, it is a very busy time and there's lots going on in the market as we sit in here in a relative enclave of calm.

I can say as far as we're concerned we've delivered a strong first half performance in 2015. Some would say predictable, but predictability in this world of volatility is actually in my view, an extreme strength. You'll hear over the half an hour or so the quality of our assets that distinguishes from some around the peer group in Australia and the region and also our future, focusing on high returning projects into the next few years.

We're uniquely situated to weather volatility and the storm that is in the oil and gas and market space at the moment. I'm sure that you'll pick out that story as we go through this morning's presentation. Firstly, a disclaimer, I'm going to be giving you the highlights this morning. Stephen Gardiner will give the financials. Julian Fowles will talk about PNG production. Gas development will described by Ian Munro. Exploration appraisal by Keiran Wulff and I'll do the wrap.

Firstly safety is the number one priority in the Oil Search regime, especially as the business goes through substantial change. The focus on safety will maintain and remain at that high priority. While people are worrying about what oil price might be, what their share price might be and also whether they have jobs, focusing on safety becomes an absolute priority. We do perform very well in the Australian peer group on both recordable incidents, on high potential incidents and also on lost time incidents. That's a tribute to our leadership and the buy in by our Group and our employees in the field.

Next slide shows TSR performance and I'll probably move on fairly quickly from that. All I can say is that based on Oil Search's performance in a three - one year, three year, five year and 10 year, broadly speaking we've done pretty well against both the market and our energy peer group. Obviously TSR changes by the day and our business doesn't. It's on a slightly different and longer cycle, but overall we've consistently delivered superior TSR, certainly against our industry peers.

Our highlights for the first half I suppose are shown by strong production performance. It was a record half year for Oil Search from very strong production from LNG and our mature oil business. We also made very strong and steady progress on our important growth projects. They appear substantially, well very attractive event despite the uncertainty of oil price in the coming years. They remain in the top quartile in terms of potential returns across the LNG business, certainly in our region.

We've also seen - embarking on a business optimisation program and that really is to refocus the organisation in terms of what it needs to deliver over the next five to seven years. It also looks at efficiencies within the organisation and the opportunities to recalibrate the business and further build our value in what is a volatile environment. I'll give some more information on that later on.

What we've already seen, some of the progress of cost cutting and efficiency drives delivered in the first half. You can typically see on our OFX guidance as it being reduced by some $2 a barrel and now stands at somewhere between $9 and $11 of EOE with more to come. So we're already starting to see that. I suppose I want to highlight that cash flow priorities in terms of debt servicing, in terms of dividend and high value growth projects remain the same.

If you look at the numbers and Stephen will give more on this, but our net profit was up 49% to just over US$227 million. It was a 49% increase in - from the first half of 2014 and also compares more favourably with the second half of 2014. It was the highest half year profit in the company's history. That was achieved despite a weaker oil and gas prices. Total revenue increased by 69% to just over US$863 million, driven by more than a threefold increase in that production base.

Unit production costs fell by 43% to US$8.90 per BOE. With very strong cash operating margin, one of the best in the region and of about 75%, our net operating cash flow more than doubled to over US$516 million, while our balance sheet remains strong with liquidity of around US$1.6 billion. It really is - and demonstrates that the assets that we have in Oil Search in PNG are world class assets and demonstrate strong profitability and as ongoing - and have the capability to apply funds to our growth projects.

Consistent with the dividend policy, we announced an interim dividend of US$0.06 per share, which is about a 40% payout ratio, very much in line with our current guidance. We'll that I'll throw it over to Stephen.

Stephen Gardiner: It's been mentioned we've got some good news in a fairly stormy day unfortunately. Let me drill down a little bit further in some of the details around our financial performance and also focus on the outlook for the full year.

As Peter's already highlighted the PNG LNG project underpinned a 69% increase in our revenue and a 54% increase in our cash earnings compared to the first half of last year. We sold 52 LNG cargos in the first half of this year and delivered 1.6 million barrels of liquids from the LNG project. Our cost of production, in line with that increased LNG production went up 53% and our non-cash charges almost increased threefold due to that full period of production.

We also saw a doubling of our financing costs, reflecting the borrowing costs in the PNG LNG project and which were expensed for the full period in the first half of 2014. Most of those costs were capitalised during the construction phase of the project. Our tax expense of US$90 million for the period equated to an effective tax rate of just over 28% with our LNG earnings, PNG and a number of our oilfields also converting to gas fields for tax purposes and with about 50% of our oil production now being taxed at a 30% tax rate. We had some one off adjustments which reduced our effective tax rate just below 30%.

As Peter mentioned, a real highlight for us is our operating cash margin at 75%. That's despite our realised oil and gas price falling to just under US$57 in the period, a 49% decline on the first half of last year. LNG and gas prices also declined by 28% and despite these price drops our cash earnings performance was supported by strong cash margins from the LNG project, but the combined margin of 75% demonstrating the real quality of our assets and our ability to ride through this very tough operating market at the moment. In particular our PNG LNG cash margin was at 83% which is very impressive given that that includes the cost of shipments for those cargoes that are delivered ex-ship.

A little more detail around our cost structure, our unit costs of production, as Peter mentioned reduced from US$15.49 per boe in the first half of last year to US$8.90 in this half due to the impact of the lower LNG unit costs and the initial benefits of cost efficiencies we were driving through the organisation.

I think a more helpful comparison though, is with the second half of 2014, which covered a full period of LNG costs and production, compared to that period our production costs reduced by 16% in absolute terms and by 19% on a unit of production basis. For our own business - oil and gas business where we do have direct operating control and can derive costs more directly we decreased those costs compared to the second half of last year by US$2.90 per boe.

It does confirm that realising value related benefits we're driving through the organisation focusing on labour efficiencies, lower supplier contract rates and savings in areas such as chemicals, fuels and transportation. We're also benefitting from favourable foreign exchange movements. There's more work to do in this space and Peter's going to give some detail on that at the end of this presentation.

Supporting the strong operating earnings is a very material increase in operating cash flows, up almost more than double thanks primarily to the PNG LNG project, be it aroundUS$36 of operating cash flow on each barrel of oil equivalent that we delivered.

Our operating cash flow covered investment spend by more than 1.6 times. We also utilised cash during the period to fund the very large dividend we paid - final and special dividend for 2014. We paid out US$183 million during the period for that.

We also received during the period the first cash from the PNG LNG project in February and used that repay all our corporate debt. One thing is very clear at the moment you need to have a very strong balance sheet and liquidity position to ride through the current conditions that we're facing. For Oil Search that's certainly the case.

We have over US$800 million of cash in the bank at the moment and $US750 million of undrawn bank loans. Our position has been boosted by the achievement of the PNG LNG project completion in February of this year and already we've received just over US$1 billion of cash release from that project.

We have US$4.29 billion of debt outstanding, all related to the PNG LNG project. That debt gets repaid over the next 11 years on a mortgage style repayment profile. We made the first payment against that debt in June - a small tranche of US$46 million.

Turning to the investment outlook for the full year, our full year capital expenditure forecast is slightly higher than our previous guidance, up by about $US50 million. The range is now around US$650 million. It is still the lowest CapEx spend since we sanctioned the LNG project back in 2009. Our LNG project development spend has increased to capture the cost of the unbudgeted 13 Angore well and also our exploration forecast range though is unchanged, despite having higher drilling on the PRL15 Antelope wells and also the unbudgeted Antelope 4 site track now in the forecast. That's been offset by a likely deferral of the Taza 4 appraisal well into 2016.

Our production CapEx forecast is also stable with the second half spend mostly focused on sustaining CapEx and some well work activity.

Turning to our full year guidance, full year guidance was unchanged from the revised guidance we've provided in July. Our production outlook has been upgraded as Peter mentioned, to 27 million to 29 million barrels of oil equivalent. Our production cost range is also lowered to the US$9 to US$11 per boe range. That captures the cost savings already generated in the first half of the year and those we're targeting for the balance of the year.

Importantly that range also includes the one off implementation cost for the business optimisation program we're about to embark on. There's no change to the guidance and we're in a pretty good place - best as we could hope for to ride through these very challenging conditions and on that note I'll hand over to Julian, thank you.

Julian Fowles: Thanks very much Stephen and good morning ladies and gentlemen. I'll tell you a little bit about our production and the production performance that has underpinned the strong financial performance that you've seen just demonstrated by Stephen.

What we've seen in the first half of the year is the highest year of production in Oil Search's history. We've seen total production over 14 million barrels equivalent which is close to triple where we were 12 months ago. PNG LNG continues to produce above nameplate and I'll give you some of the details around that on the next slide. Our operated oil field production has also been on target for the year, so pretty good summary for that first half of the year.

If we look specifically at the PNG LNG project it has been, as I said consistently producing above its nameplate capacity of 6.9. It's been producing an average rate of 7.1 on an annualised basis. We actually just loaded the 120th cargo between yesterday and today, so another milestone - fantastic performance there from all elements of the facility. That goes right down to the wells - the wells and Hides producing exceedingly well and goes all the way through the Hides gas conditioning plant and the LNG plant itself. All the facilities are performing extremely well.

What we've established now of course with that great production is a good reputation with our customers as a reliable supplier of LNG into our markets. We're currently now focused on looking at debottlenecking opportunities. The operator has a team working on that to see how we can best debottleneck the facilities and what production we can end up getting out of it.

We expect in any case through the second half of the year that most likely we'll see higher than the 7.1 million tonnes per annum that we've seen in the first half, so as I said expect a good performance.

There's a couple of projects that are also still ongoing as part of the foundation of the project. The Hides have one. That's completed through the main reservoir zone and that time is being done. Of course the finalisation of the drilling with the second Angore well. That is ongoing and expected to be completed this year.

In terms of where the - our LNG is going. I think it's really important to emphasise that all of our customers are taking their full contract volumes and we see extremely strong demand for export cargoes. That reflects the quality I believe of our LNG - the quality of the product. This is some of the highest heating value gas you'll find in the region and it fits very well with the customer reticulation network that they have domestically.

There's another thing I'd like to talk a little bit more on is performance in our operated oil fields. This is obviously a big focus for us and it underpins what Peter mentioned at the start around our safety performance. As we said, we've had a good safety performance so far this year and touch wood that will continue.

We've seen the start of the third party gas supply into the PNG LNG projects in South East Gobe and that facility has been performing very well. We continue to see extremely good performance from the main oil fields around Kutubu and Moran, which currently are contributing around 80% of our operated production.

We continue also to see good performance from new drilling and completions in our operated oil fields, so the Moran 16 development well drilled earlier this year has been coming in at 1500 barrels a day. That's an excellent performance - and also the North West Moran well which we've just completed drilling. We expect to tie that one back over the next month or so. Again we'll expect to see production rates there in the order of 1500 barrels a day.

This is great for infill wells in fields which are in the later stages of their life - declining fields, so, great production performance from our operator facilities.

If we look at the 2015 outlook, we've recently increased our guidance from 26 million to 28 million, up to 27 million to 29 million barrels equivalent. That's comprising obviously our operated oil fields and the contribution from PNG LNG. I guess if I looked at that I would expect us to be towards the upper end of that range as we go through towards the end of the year.

Of course we're maintaining our focus on safety, on optimising our own production and on continued synchronicities if you like with the PNG LNG project and our operations. I think that's important to continue to emphasise that. So, I'll leave it on that and hand over to Ian, who'll tell us about gas development.

Ian Munro: Thank you Julian, good morning ladies and gentlemen. As you heard from Peter today, Oil Search's development - Oil Search's development focus remains the delivery of higher returning LNG projects in PNG - a combination of strong cash flows, a disciplined approach to portfolio expenditure and a quality resource base combined to position Oil Search for continued delivery of top quartile returns for shareholders.

The undeveloped resource space in PNG, which is primarily held in two fields - in the P'nyang and Elk-Antelope can supply one new train each. Early indications from drilling in PRL15 suggests that a second train may be possible at the Papua LNG Project.

Oil Search held the material interest in both of these projects and these helped to meet the supply shortage that is forecast early in the next decade within the Asian LNG market. A third train at PNG LNG and the Papua LNG Project are considered to be among the lowest capital projects globally and they both remain economically attractive in the current price environment.

Longer term we've identified exciting exploration potential in-country which can continue to meet expansion opportunities of high quality gas for backfill.

In the North West hub development is progressing well. Following the execution of the MOU, the PNG LNG and PL 3 joint ventures and government are delivering on commitments to an agreed schedule. This will place the co-venturers in a position to consider a final investment decision on an expansion train by the end of 2017.

The operator recently highlighted the traction of this expansion of the project. As a reminder, installed downstream common use of capacity at the plant, control rooms, storage tanks and jetty and also the spare capacity in the export alliance from Kutubu.

The PDL field development plan and environmental impact statement are all currently being reviewed by government. Land owner development forums will commence in the near term ahead of appraisal drilling in the first half of 2016.

On the resource side, the primary objective for the appraisal well is to provide greater certainty around the 1C resource volume and also the 2C volume low financing and marketing activities. Successful appraisal would confirm initial findings from the joint venture, from both new seismic and core data that indicate a material increase in the 2C resource of the field.

The excellent performance from the Hide's field that Julian has talked about and production through the remainder of this year into 2016 will be evaluated to determine the resource size and the potential contribution to the expansion project. Finally, the integrated commercial structure which has been selected for P'nyang will help to facilitate the path to FID.

In the Gulf province the PRL 15 joint venture has also made material progress on commercialisation of Papua LNG. 2015 is primarily about quantifying the resource through the completion of the appraisal program and determining if a resource size can underpin a one or two train development.

In parallel, the joint venture has selected the locations of the key project infrastructure sites, which have allowed for detailed geo-technical surveys to commence during this quarter. The first half of 2016 will see a number of key project milestones. Concepts selected on either a one or two train development, commencement of basis of design, planning for those important early works and also Oil Search certification.

There is an opportunity through lessons learned at PNG LNG to commit to targeted pre-investment in enabling infrastructure and critical path items to protect execution schedule. Of course such investments can only be made with a well-defined resource space.

It's fair to say the results of the appraisal program to date have been encouraging. Both wells are a little high to Oil Search's prognosis and encountered extremely high quality reservoir. Initial testing In Antelope 5 demonstrated excellent reservoir deliverability across the core of the field and reduced the likelihood of a low resource outcome.

The longer term interference test following the drilling of Antelope 4 side track will provide valuable information to further narrowing the resource range. Antelope 6 will complete the appraisal well program later this year and is targeting a lower quality reservoir expected on the eastern flank of the field.

Given the appraisal program is only half complete, it is evidently too early to know whether the resource can support a two train development. However it is clear from project economics that is all co-venturers interest to prove it a resource that can underpin a two train development.

Oil Search itself has engaged two world class certifiers, Gaffney Cline and NSAI. They'll determine an accurate assessment of volumes in the field. You'll be familiar that GC has a long association with the Antelope reservoir and NSAI of course are the joint venture certifier for PNG LNG. The certification process will take around four months following completion of Antelope 6 and results are expected around May next year.

Once the important process of quantifying the resources is complete both projects are expected to ramp up their marketing activities. A number of well-respected forecasters show there is expected to be a sizeable volume of LNG demand opening early in the next decade, even accounting for forecast volumes out of the US. It is this window that Train 3 and Papua LNG will target. Given the reputation that PNG is building for reliable LNG supply into Asia, we believe that both projects can successfully place long term volumes into a market that may have upward of 100 million tonnes per annum on contracted demand by 2025.

Whilst there are many proposed LNG developments globally it is likely that a combination of cost pressure and the consequent economic returns will result in deferral of many of the competing projects. The cost base in PNG allied to both attractive and stable fiscal terms provide confidence to the joint venturers and to Oil Search that both projects will move forward to timely investment decisions.

In summary, key takeaways from what is a core pillar of our business, I believe we are in an enviable position of holding a material interest in two high quality resources that are expected to meet a near term growing supply demand gap in Asia. Both joint ventures are fully aligned on progressing the projects to the earliest investment decisions and critically this is also the focus of government in PNG.

The developments are robust in a revised oil price scenario and consequently capital will be prioritised across Oil Search's business to fund the activities. The location of both projects in Port Moresby provide opportunities for the joint venture to look for synergies around lowering capital and operating costs.

Finally, as we look forward to the future we're particularly excited about our exploration portfolio in-country, which we believe will continue to provide a feeder through for the infrastructure that we put in place. Keiran will now highlight this infrastructure - sorry this exploration.

Keiran Wulff: Okay, thanks Ian and welcome everyone in these challenging times. What I'd like to do over the next few minutes is really show you how we're going to take advantage of these challenging times for everyone else, to really build a long term and substantial position - further substantial position in PNG.

Over the last eight months - we'll just move forward - over the last eight months, we've effectively gone back through our entire database and recalibrated our position in PNG with respect to where we're going to focus with a view that we certainly see that there's massive opportunity in PNG - certainly probably the same again in terms of reserves to be found in the country.

What we'd like to do is to establish an acreage program that supports our LNG expansion, expands on our conventional oil players of which we see continuing trends there to chase. Also, we looked at every single reservoir [that appears] in the country to identify the future game changers so that Oil Search is at the forefront.

What we're looking at doing is putting in place a very predictable drilling program over the next number of years that is a balance between focusing on high value exploration in and immediately along trend from our LNG expansion, appraisal of our existing discoveries and also new field exploration in remoter areas.

Probably the most exciting thing that's happened in the last little while which we'll be taking advantage of is really focusing on our drilling costs. You'll see in the presentation coming up there are a number of areas that we're looking at innovation to substantially drive our drilling costs down, especially in the Foreland area where we've got a program coming up.

To put it into perspective, our next 18 months program is going to be targeting about seven tcf of prospective of unrisked resources. There would be a balance between three areas, exploration immediately and along trend from existing discoveries at - and LNG developments at Hides and Antelope. That will be up in the North West area at P'nyang and Strickland and Muruk.

We're also very excited by what we're seeing in the Gulf area with the Miocene play. Obviously Antelope is a significant LNG potential development which we're obviously involved in, but what we see there is a number of analogues in the region which we're in the process of evaluating and preparing a drilling program over the course of the next 12 months.

You will see us drill two wells in that area, which will be Antelope South and Kalangar 1. Kalangar is a new prospect along trend from Antelope and it actually - effectively there are three prospects immediately along trend from Kalangar, which will be follow up.

One of the other things we did in the first half this year was to re-evaluate our entire existing acreage portfolio with respect to the reserves in our PRLs. Last week we received a five year extension for our PRLs from the PNG government. The review that we undertook of those PRLs highlighted that significant upside reserve potential had existed in all of those PRLs both in Kimu, Barikewa and Uramu. I'll talk about that shortly.

With respect to Muruk, Muruk is immediately on trend from Duha and just west of Hides. It's a multi-tcf prospect which will be drilling potentially mobilising equipment in the next few months and drilling early next year. It's a prospect that we have 50% in with Exxon and we are the operator. We will also be participating in drilling in P'nyang, at P'nyang's looking at two appraisal wells in P'nyang and also potentially two exploration wells with Repsol in 269 at Strickland, and then there will be a further well to be defined once we've completed the evaluation.

As I said further in the - as I move to the next one - the Aure and the Gulf area is really a new petroleum province that actually offers an awful lot of upside in the area. If you look on the top right-hand corner you'll see the Antelope South well. All three companies have independently mapped Antelope South. Whilst it's deeper and a little bit further to the south from the Antelope field, all three companies have come up with a very similar crestal position and that will all be drilled and has been confirmed as being drilled by the joint venture early next year. It has a wide range of reserves and you will have seen that InterOil have got a very large potential on it. It certainly has that potential, but at the moment we are looking at a more conservative approach which still is significantly attractive given its location to Antelope.

The exciting thing about Kalangar is that it's a very similar looking feature seismically to Antelope. It's an area that we have a significant equity position, we have 70%. Also more importantly, it's an area that's covered by logging roads. So we're able to bring in a small scale rig with a small footprint; something that we can rig up very quickly. The intention is to drill these wells very effectively and cost efficiently. It's an exciting region and we see significant growth potential in that area. The attraction about that area is that it obviously doesn't have the same capital cost exposure that the North West Foldbelt does. But it still has very similar reserves potential.

If I look at the Forelands and Gulf area, the Forelands and Gulf area is - the slide in issue, but anyway - the Forelands and Gulf areas is something that we've had three PRLs in that region for a long period of time. They really haven’t had a whole lot of attention to them. The attraction there is that - as I said - we've substantially upgraded the reserves in each and every one of those fields with a view that we're now looking at development options in regard to integrating with the existing LNG, smaller scale LNG, power generation of petrochemicals. Each and every one of those has significant upsides.

We will be drilling a well at Barikewa in the first quarter, Kimu and also Uramu later on in the year. So all three of those areas will have firm reserves by the end of 2016.

With respect to Taza we are just in the process of finalising our testing on the Taza 3 well and we are looking at having a slowdown of operational activity in Taza while we evaluated the results of the three wells, and most importantly the results of the 3D seismic that was acquired last year. As you can see on the cube, we had a very good result and outstanding quality of the Taza 3 3D seismic data. What it clearly shows is that the Taza structure itself can be separated into a series of regions from areas that appear to have relatively few fractures which where we've drilled the Tazas 1, 2 and 3 wells. So quite a very complex fracturing zone in the form of area of Taza 4.

We have only just received that 3D seismic data so there's a lot of work to do in terms of integrating the results with the 3D data. We are in discussions with Total and the Ministry in Kurdistan with respect for the program. Those discussions are ongoing as we speak.

As I said, we have a very strong exploration appraisal program going for the next 18 months, and indeed we are looking at putting a program in place - a supported drilling program - similar to this going forward with a multi-well, multi-year program. It's a very balanced 18 month program and looking at somewhere in the order of 7 tcf of unrest prospective resources. So the growth potential for not only in and immediately around our existing LNG projects, but also new frontiers in the Gulf area and the Foreland area are quite attractive for us going forward.

As I said, we're really trying to take advantage of the downturn to acquire a larger acreage position and also drill our wells at lower cost.

So in summary, it really is a multi-year, multi-well program that's going to drive long-term growth into our PNG licences. It's around supporting our long-term gas reserves. It's around our new conventional plays and looking for those game changers, similar to what Antelope did in the Papuan Basin. We see massive potential remaining in Papua New Guinea. It's an area that's going to continue our focus for a number of years to come. We see in excess of five billion barrels of oil we've yet to find, and as I've said we'll be targeting somewhere around 7 tcf over the course of the next 18 months.

We've changed our approach with respect to drilling, and we really are going to a fit for purpose approach with right sized rigs for the locations and we're looking at our evaluation commercialisation options. So in PNG we actually see a lot of upside and whilst these are certainly challenging times, we certainly intend to take advantage of them. Thank you, I'll hand it back over to Peter Botten.

Peter Botten: Thanks Keiran. I'm just going to look at the outlook and summarise where I think we're at. This slide is actually called the business environment; another possible title might be pick a number. This is obviously a view about what oil prices may or may not be into the future, with the bottom dotted line being the most recent forward curve for oil.

I suppose my view for some time has been that this is a somewhat different adjustment to oil and gas pricing in the world, driven in part by obviously over supply. But that over supply is also driven by technology and the balance between new supplies coming out of primarily North America and that in competition with OPEC trying to maintain its market share. I personally don't believe that this price is going to rebound quickly and I think therefore - although I hope it does - we don't run our business on hope, we run our business on reality. We have to manage Oil Search on the basis of a lower for longer outlook, and that's certainly where we're going.

The industry's obvious reaction to this is obviously looking at what the economics of the projects that we have in our portfolio, looking at cash flows, looking at how much discretionary spend we have, how much capital we're going to apply where, and obviously it's a painful exercise. It's a painful exercise for the people in the oil and gas sector of which thousands I'm sure will be leaving at least existing companies over the next few years. Obviously the contractors are being asked to share the pain. It's not an easy time in the oil and gas sector, it's not an easy time on the market either.

However we believe we're very well situated to actually manage our way through this. Certainly take some pain - certainly - but also see that there is upside. We are very well situated with the strength of our assets set, the profitability of those assets, along with good cash flows out of PNG LNG and excellent long-term, excellent future economic value delivered out of our future LNG business - where frankly competition I think will be substantially less than it was 18 months ago - to really drive growth in the organisation. We have two globally competitive projects in the making at the lowest quartile of cost. We think that's a great position to be in, based on managing our business very well over the next few years.

As a result of the obvious downturn in pricing we looked at our strategic review which came and was delivered in 2014. Out of that came a reaffirmation - if you like - of the core objectives and priorities. We have reprioritised and focused very strongly on managing our business, but also being able to participate in selective growth opportunities. Some of the discretional spend therefore is disappearing.

It did highlight an opportunity to fundamentally change our cost base and realign the organisation to ensure our strategic priorities are fully supported. I'll give a little bit of detail on that. Although we didn't react in any form of panic, we have taken a very measured view about what we can achieve in the organisation over the next 12 months to 18 months to recalibrate our business further. Despite our strengths, we need to recalibrate and that's what we're doing.

So we're right now refocusing the entire organisation on the core strategic priorities and where we can actually add value. We are ensuring that we're using our people in the best possible spots, and delivering our priorities which are to support our oilfields, to explore in a measured but reasonable way, and to deliver what we can to help our operators - Exxon and Total - to deliver on our growth objectives. We're taking advantage of the business opportunities set and the environment to recalibrate our supply costs and to refine a more efficient way of delivering product and material into the field through our supply chain reformation. We also see some production and operational efficiencies that can be delivered to drive up our own controlled production rates and to make it more efficient.

It's not all pain. We certainly will take our share of pain, but we also see that we can reinvest and we should reinvest in things like localisation of our workforce. We're certainly looking at expanding our Port Moresby office and putting some investment into development of the clear talent set that we have in PNG. We'll also continue to invest in some of the social programs that we think are absolutely essential to our own future in PNG and a stable operating environment. That's certainly a focus area and will continue to be as PNG itself goes through some economic pain.

If we look at some of the optimisation program and expected outcomes then, where we have operated control, apparitional control we do see that we're able to target material savings across our business. The reduction in annual operating costs, we see somewhere around the AUD20 million to AUD23 million per annum - equivalent to about AUD2.50 to AUD3.50 a boe across our business. We also see rate reductions of somewhere between 10% and 25% already achieved from our suppliers. But we think we can do more and work with them to become more efficient.

In terms of production, we see improved planning and reduced downtime is a focus area for our operations in the oilfields. We're targeting to add somewhere around 5% to current forecasts for our oil production. That is high value business and can - I think - make a difference to our cash flows in the 2016/2017 period.

The growth focus is maintained in the organisation and although we will have very strict - and have very strict - capital management priorities, there will be capital available for measured exploration and allow some spend clearly on the value business of growing our LNG projects. Clearly our focus over the next few years is to make sure our balance sheet is in the best possible shape to support the development of PNG LNG, and also Papua LNG.

Some restructuring costs are inevitable through this process and we have already accounted for them in our future outlook. It will be a painful exercise, but for Oil Search it is one that will put us in great shape to further develop and deliver value in our business. Against our peer group we think we have certain advantages in both our assets and our future potential that are clear and distinguish us from others.

If we look at key milestones of 12 months to 18 months, we clearly see that the focus in 2015 is to continue to optimise what we've built with PNG LNG. As Julian has said, it's been an outstanding performance - we've seen an outstanding performance - from PNG LNG and we see that there is further upside in what we can put through that plant. Right through the chain of production, from production in Hides through to the plant itself in Port Moresby, there continues to be upside potential future debottlenecking.

We also see that we will see progress towards a PDL for P'nyang under their government MOU, which gives us a predictable program to move that development forward. We also see further drilling in Elk Antelope, and hopefully in the second quarter next year we'll have a revised number on reserves and one that provides the platform to expand. Obviously that goes into 2016 highlights.

A range of exploration plays are also there, Keiran has described those. A range of wells which we think are targeting a substantial gas resource which can contribute to the next phase of gas development in both PNG LNG, Papua LNG, and of course other potential opportunities in country which are very important to the government.

In 2017 we also see obviously critical decisions on expansion activities for PNG LNG, ongoing feed and hopefully a possible early works for Papua LNG, and obviously continued exploration and appraisal activities across our portfolio.

In summary then, Oil Search is in - despite the oil price and gas price - good shape. We have a very strong production, and that production shows excellent performance from both our oilfields and PNG LNG. PNG LNG is performing well above nameplate capacity right now and there is potential to further increase that production base. We are working very closely with ExxonMobil to try and see that happen.

These are high margin barrels, and one of the advantages we have is that we continue to have in our portfolio attractive profitable barrels across the space. Our margins are higher than most people in the region and we will continue to optimise that production through our business optimisation program. We will continue too to reduce our cost base, optimise our efficiencies across the organisation and across our operations and obviously continue to focus on safety as these changes roll through the organisation.

Some results have already been delivered in the first half. However there are more to come, and clearly the priority is for PNG LNG expansion and the growth of Papua LNG into an environment which is much less competitive, albeit challenged in terms of capital and in terms of market. We believe it is the right time to move on these projects, to deliver into what may be a different environment in the early part of the 2020s.

Revitalised exploration is also part of the story, and again something that distinguishes us. We have clear, defined growth and an ability to fund that through the next few years, all built on a sound balance sheet which is being very actively managed to put us in the best possible shape to support the LNG growth.

So with that in mind, thanks very much for your attendance. We'll throw it open to questions from the panel - to the panel.

Dale Koenders: (Citigroup, Analyst) Morning, Dale Koenders from Citigroup. Peter, I just wanted to ask a question in terms of the timing for expansions for the two projects, how did that tie in with your exploration program maybe allocating some of that gas into those expansion projects? Or do you think it's a future phase?

Peter Botten: Look, I think - I mean clearly our focus for PNG LNG expansion is to use good reserve - strong reserve positions - at Hides and the oilfields along with P'nyang, and clearly the focus is to appraise P'nyang and move the 1C resources up to support an optimised growth. However I think it's realistic to say that if you do have gas reserves proven up in any potential development, clearly if you find gas at Muruk that's an interesting game changer. But I think you have to put in perspective if you're doing appraisal you can prove up reserves reasonably quickly. If you're doing exploration it usually takes more than one well. So that adds some time aspects to it.

We're not relying certainly on the exploration side, but we think that gas is valuable. As we put in that next phase of LNG infrastructure, knowing where the resources are will impact how that infrastructure gets put together. But I mean clearly our focus is still to utilise what we already see and appraise what we've already got. But there is further growth.

Dale Koenders: : (Citigroup, Analyst) In terms of the timing for the FID decision end of 2017 for train 3 and I'd assume 2018 given that's not on the slide for Papua LNG. Do you see risks to that timing given the ongoing appraisal and the reserve certification is yet to be completed?

Peter Botten: Oh look, I think it's already manageable. I think it's easier to commit to a train 3 and an expansion of PNG LNG which also includes debottlenecking than it is right now from our Papua LNG. These projects, they are major projects and there are always risks to timing and certainly there is a lot to do, but there is a lot less to do for a PNG LNG expansion than there is for a Papua LNG development. Bearing in mind we will not probably get the reserve resources understood for Papua LNG until second quarter, I think that next year that then leads to a series of issues, fiscal negotiations, financing et cetera which I think makes the '17 target very challenging.

But like everything you are clearing your mind, you are clearing, putting a focus on trying to get this done quickly. Certainly in country in PNG there is a very strong need to see exploration and development activity enhanced to bolster the economic benefits that flow from the resources sector, so there is a very big challenge put on us by government to meet those timetables.

Dale Koenders: (Citigroup, Analyst) Finally, in terms of the $7 billion CapEx number for LNG developments over the next seven years can you provide some colour, sort of is that two trains for Antelope, is that one train, I assume there is a couple of billion dollars in there for Juha within PNG LNG. Is that set on the cost base of the sort of $100 a barrel oil environment or is there a cost out that is included in those numbers or is that a future opportunity?

Peter Botten: I think you can describe that as a future opportunity. I do not believe that we have necessarily fully addressed the capital costs for some of those projects in an updated way. I think there is a real opportunity to sharpen the pencil on those and that is something we inevitably will do when we go to the market. You go to the market when you want to go to the market because I think there are going to be a lot of hungry people, a lot of hungry contractors out there and there are certainly a lot of hungry people in Oil Search to make it happen. So I think there is time for that in 2016/17.

Kirit Hira: (Macquarie, Analyst) Morning, Kirit here from Macquarie. Just a couple of questions on the cost initiatives; in terms of I guess the targeted unit cost savings you have mentioned here that excludes any cost initiatives delivered by PNG LNG. I am just wondering outside of the obvious production improvements that were commented on in terms of second half, if there are actually any formal cost initiatives that Exxon are planning?

Peter Botten: They certainly are very focused on costs. Perhaps Julian you could elucidate a little bit as much as we know.

Julian Fowles: Yes, look it is still relatively early days with LNG project. We are about a year into production so there is still quite a lot of getting used to the facilities if you like and testing what those facilities will do. A lot of that work is obviously going well as we have seen from the current production that we get.

In terms of cost saving initiatives, Exxon as Peter said is certainly focused on that. They have focused on areas where they can get better synergy with our existing Oil Search operations. We are looking at how we can share logistics, how we can share some of the supply chain and also how we can share facilities, staff facilities if you like across the highlands area. So there is certainly quite a big focus for Exxon as the operators of that project in terms of cost savings that they can make.

But as I said, it is still relatively early days with, what with the all the facilities. They are performing well so far and as I said we expect to see that…

Kirit Hira: (Macquarie, Analyst) …question on exploration. Obviously a fairly active exploration program over the next couple of years, subject to oil prices, I am just wondering how much of that is driven by commitments versus I guess economics? Obviously you have mentioned that some of the retention licenses - I think Keiran might have mentioned - have been renewed if most of that has been actually just commitment.

Peter Botten: Keiran I will throw that to you.

Keiran Wulff: Yes sure. With respect the work programs in the PRL there is well obligations, but the well obligations just have to be drilled within a five year period. What we have seen is that there is significant upsize in those PRLs at both Kimu and Barikewa and also at Uramu. So we are actually bringing those forward so that we can see how they actually fit into the overall gas picture in PNG. The reserve upgrade potential is quite significant, so no we actually - whilst they are commitments over a five year period we see there is a lot of value in actually doing them sooner and also taking advantage of the lower rig costs that are actually - yes, we see likely to be prevalent going forward.

Peter Botten: Are there any more questions in the room? So we will go to the line for the phone I think.

Operator: Ladies and gentlemen if you wish to ask question from the audio please press star one on your telephone and wait for your name to be announced.

Your first question comes from the line of John Hirjee from Deutsche Bank. Please go ahead.

John Hirjee: (Deutsche Bank, Analyst) Good morning everyone. My question Peter is to you in terms of the PNG LNG cargoes and what customers are saying. I noted with interest that you said that over 85% of your spot cargoes have been sold to contract customers. So you are seeing that demand remains relatively strong for the product from PNG LNG?

Peter Botten: We certainly are seeing that. Perhaps Julian you might fill that in, but you know there certainly were a number of rumours around customers not taking its reserve and not taking its contract volumes. We are not seeing that at all and in fact the even spot cargoes have been very well received. I think it is a function of the quality of the gas, the high energy content. Frankly we are doing well against all of those metrics.

Julian you might want to add that, because it has been a focus.

Julian Fowles: Yes thank you. John, how are you doing? The demand for the product has been extremely high I have to say. We have ramped up obviously all the contracts. They are all taking; all the customers are taking their full contract volumes. There is still some ramp up of that to do as we go into 2016. Above that, all the customers, all the current contracted customers are also taking very strongly our spot cargoes.

As Peter has said and as we have emphasised before, it is really the quality of the product itself. As we look forward in the year there is actually not very many spot cargoes for the rest of the year anyway. As I said we are ramped up on the contracts themselves. But extremely strong demand; we do not see any weakness in that whatsoever.

John Hirjee: (Deutsche Bank, Analyst) Great. Thanks. Another question if I may, probably directed to Stephen Gardiner. Stephen can you just remind us in terms of the cash balance that you have, you have got some escrow, what are the conditions of the escrow and will that escrow ever come out?

Stephen Gardiner: John, yes, thanks. At the moment we have about $182 million in escrow. It has got two components. One is an amount that is required to cover six months of interest and principal repayments, so that will grow as that amount increases in the next year or so. Then the balance is the surplus over that that is left after servicing operating costs and other expenditures which gets released on a semi-annual basis. So that amount will change over time as our future principal and interest repayments change over time.

John Hirjee: (Deutsche Bank, Analyst) Right, but just to reconfirm that your project finance is now non-recourse, correct?

Stephen Gardiner: It is non-resource. Our guarantee was released at financial completion back in February.

John Hirjee: (Deutsche Bank, Analyst) Great. Thank you very much.

Operator: Your next question comes from the line of Nik Burns from UBS. Please go ahead.

Nik Burns: (UBS, Analyst) Yes, thank you. Just come questions around PRL '15. If you can help us just understand, there has been I guess a difference of view in terms of some aspects of the acreage there between yourselves and InterOil. I think InterOil recently talked about the potential to drill Antelope 7 and it looked, from what Ian said today that the appraisal program would be complete after Antelope 6. Have you made the determination that Antelope 7 is not required there?

Peter Botten: Over to you Ian.

Ian Munro: Your question is a good one. The joint venture at the moment, the final approved well in the program is the Antelope 6 well, which as I said will target the eastern flank of the field. There are still ongoing discussions within the joint venture, now of course led by Total as the project operator. But as of today Antelope 6 is the final well. Antelope 7 has been discussed and I know it has been out there through InterOil potentially targeting some upside at the west of the field and that upside may actually be there, but whether we actually need to drill a well will be determined certainly following Antelope 4 side track where we have a pretty extensive well test program and there interference test should give us far more information around the size of the resource and certainly connectivity.

Nik Burns: (UBS, Analyst) So if a decision was made to drill Antelope 7 would you anticipate that would push back the timing for certification or do you think that would be a work program that would happen subsequent to certification?

Ian Munro: Look I still think that is a decision the joint venture have to make. As of today there is no Antelope 7 on the drilling program. Clearly if the joint venture decide they need to drill seven to target that upside, then I think yes, that would push the project schedule to the right.

Nik Burns: (UBS, Analyst) Okay, and just on Antelope South, again InterOil has talked about 5.5 tcf in the P50 case, you are saying today 1 tcf. That is quite a big difference. What are the key drivers in that gap?

Keiran Wulff: Nik, it is Keiran. All three partners have mapped a relatively similar crestal location for the Antelope South. It is relatively poorly constrained so it is model driven with respect to the ultimate configuration of the field. So as a result of that there is a very broad range of reserve potential in the exploration component of that well. So it is really just the way that each of the interpreters have mapped it and the most important point here is that all three partners - Total, InterOil and ourselves - have all agreed on a crestal location to drill. So even at a reduced volume it is a very attractive volume to chase. We would very much like InterOil to be right.

Nik Burns: (UBS, Analyst) Okay, great and just a quick final one from me just on award of PDL over the P'nyang permit. I think at the start of the year there was a timeline of end of first quarter for that award. That still has not come through. What is the reason for the delay there?

Peter Botten: I will answer that Nik. There is a whole range of stuff piled up in the Department of Petroleum at the moment. There are sensitivities around the land owner and land owner involvement in the field and frankly this is just a process that the government are going through. The joint venture I believe has done as much as possible to provide the government with the information needed and we anticipate that land owner discussions and forums et cetera will be kicking off relatively soon. That really is the precursor for any PDL award. So I suppose we are working closely with Exxon, working closely with the government around this to expedite it. In actual fact it is progressing but progressing in a measured way.

Nik Burns: (UBS, Analyst) So there are no implications of a delay here on the end '17 FID target?

Peter Botten: Certainly I do not believe that to be the case and certainly that is, we clearly need to get after the drilling on P'nyang which is the critical point; to progress that and understand the resource base. So at the present time we are working closely with the government and Exxon to expedite, but there is also some sensitivity in the land owners and land owner groups to make sure we get it right. We do not want to push too hard but we just need to keep the pressure on.

Nik Burns: (UBS, Analyst) Great. Thank you.

Operator: Next question from Mark Samter from Credit Suisse. Please go ahead.

Mark Samter: (Credit Suisse, Analyst) Morning guys. A quick question around PNG LNG. Obviously one of your JV partners has very publicly suggested that none of its assets are sacred and are considering sales of any and all of them. Just wondering, I mean first of all can you talk us through some of the technicalities around the pre-emption that should PNG LNG state come up to the block and also your guys appetite, I think with the emphasis at the right price, your guys appetite to take on more of that project potentially through the pre-emption or through the ability to with the other JV partners look at that asset?

Peter Botten: Thanks Mark for that question.

Mark Samter: (Credit Suisse, Analyst) It was going to be me asking you one…

Peter Botten: You could put on your research brief tomorrow. I am sure it will be erudite. What I can say is that the pre-emptive rights for PNG LNG holders are very very strong and I think they are in fact as close to bullet proof as you can possibly make them, so any potential sale I am sure will be subject to some pre-emption rights by other parties.

Like everything we may or may not be interested, but I am sure other parties in the joint venture may or may not be interested and to a degree that will be driven by circumstance - our views of oil price, our views of cash flows and probably more importantly our views of price. But we watch with interest.

Mark Samter: (Credit Suisse, Analyst) I guess it is fair to say, I expect we all agree that PNG LNG is not being particularly fairly reflected in your share price so you would not want to pay at a higher oil price than is being reflected currently in your share price, and I certainly already am, a good lick of.

Peter Botten: I think that is a pretty reasonable reflection of reality Mark.

Mark Samter: (Credit Suisse, Analyst) Just one really quick question, far more vanilla question from me, the spot cargoes that are being sold, are they just purely on just a standard spot contract or is there any kind of contractual mechanism with the existing buyers, because it appears like you are realising probably higher spot prices than other spot sellers are. Is it just purely because of the quality of the resource on the project?

Julian Fowles: Yes, hi Mark it is Julian here. The spot cargoes are going out just into the normal spot market, obviously to our contracted customers. The price we are seeing is relatively strong price and again that reflects, I think as you have indicated there, the quality of the resource, the quality of what we are selling. I think it is a relatively simple equation with that.

Mark Samter: (Credit Suisse, Analyst) Perfect. Thanks guys.

Operator: Next question is from Stuart Baker from Morgan Stanley. Please go ahead.

Stuart Baker: (Morgan Stanley, Analyst) Good morning gentlemen. Peter, just a question on reserves situation for Train 3, all this bottlenecking, obviously a lot of moving parts with P'nyang certification, Hides process, et cetera. Just reading there the P'nyang South 2, obviously on a new fault block, how critical is that to the resource equation? It says there on Page 25 assuming successful appraisal it would increase the resource base quite a bit. What happens if that well were not successful and what are the steps after that the joint venture would need to take to make sure the reserves in all of the fields are at the level needed for a third train?

Peter Botten: I think there are a number of aspects to that. I mean firstly we have an obligation under the agreement with government to develop P'nyang and develop P'nyang as soon as we can practically do so. So the reserves at P'nyang are important and there is a fairly substantial gap from the proven resource to what the 2 and 3p resource at P'nyang might be. So all these wells are important and certainly if you have to develop a field you want to optimise that development on the back of the best possible reserve knowledge base.

The reality is that there will be contributions undoubtedly to expansion activities from all our fields and optimising that is part of the exercise that is ongoing and understanding resources and how you tie in which field at when is part of the analysis that is happening now.

Ian do you want to comment any further on that?

Ian Munro: Perhaps just specifically the well is actually a long strike and targeting a fault block which has already been penetrated. So we are already including 2c volumes and they have already been sort of certified. What is I think we are looking for for that well is 1c. We need to increase the 1c basis so we can really get after the marketing and financing.

Stuart Baker: (Morgan Stanley, Analyst) Thanks very much.

Operator: There are no further questions at this time.

Peter Botten: Thank you very much ladies and gentlemen for attending this morning. I wish you luck in the relative volatility of the market when you leave the room. Thank you very much for attending.

End of Transcript